BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
McVICAR - ROOD CORPORATION)

Appearances:

For Appellant: T. B. Irvine, Attorney at Law.

For Respondent: Burl Lack, Acting Assistant Franchise Tax Commissioner.

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes Of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of McVicar-Rood Corporation to a proposed assessment of additional tax in the amount of $1,864.63 for the taxable year ended December 31, 1938.

During the income year 1937 the Appellant, a California corporation, owned substantially all the stock of six oil producing corporations from which it received dividends in the amount of $114,300. Each of the subsidiary corporations received its entire income from business done in California. Pppellant appears to have operated the subsidiaries, supplying to them all labor supervision, supplies, tools and machinery and being reimbursed by them for all labor and expenses and receiving $150 a month for each well supervised. Appellant also drilled and operated two oil wells on lands leased by it during the year.

Objection is made by the Appellant to the proposed assessment in so far as it results from the following adjustments made by the Commissioner in the computation of its net income:

(a) the inclusion within the measure of the tax of a portion of the dividends received by it during 1937 from its subsidiaries;

(b) the reduction in the depletion allowance claimed by it from $21,380.32 to $2,660.56.

So far as the first point is concerned, we need look only to the recent case of Burton E. Green Investment Company v. McColgan, 60 Cal. kpp. (2d) 224; hearing denied by California Supreme Court *October 11, 1943. In the present case, as in the Green case, the dividends were paid by corporations whose entire income was received from business done within the State. The fact that the

depletion allowance to which each of those corporations was entitled under Section 8(g) of the Act exceeded the depletion sustained by it when computed on the basis of cost was held in that case not to furnish a basis for a determination by the Commissioner that the dividends of those corporations were declared in part from income which had not been included in the measure of the tax imposed by the Act on the declaror corporations. It follows, therefore, that the dividends here in question, though includible in Appellant's gross income, are deductible in their entirety under Section 8(h) of the Act.

The Commissioner's action in reducing the deduction for depletion to $2,660.56 is based by him on the 50 per centum of net income limitation on the deduction provided by Section 8(g) and certain adjustments in the computation of Appellant'snet income from the wells. These adjustments, which resulted in a net income from the property in the amount of $5,321.13 for purposes of such limitation, involved the deduction from the gross income from the two wells of $37,929.27, representing intangible drilling costs in excess of income received from the sale of royalties, and $16,232.13, representing the portion of Appellant's overhead expenses deemed allocable by the Commissioner to the operation of the wells.

We have already had occasion to pass upon the deductibility of the intangible drilling costs. In the Appeal of Franco-Western Oil Company (July 7, 1942) we held that a taxpayer that deducte intangible drilling and development costs as expenses in computing its taxable net income must likewise deduct such costs in computing its net income for the purpose of applying the 50 per centum limitation upon the depletion allowance provided by Section 8(g) of the Act. The Commissioner also acted correctly in our opinion, so far as the question of the allocation of a portion of the overhead expenses is concerned. He prorated the overhead expenses on the basis of Appellant's gross oil income of $77,213.28 and its gross other business income of $43,785.77, but without regard to the dividends received by Appellant of $114,300. In support of its objection Appellant states only that "The dividends in question were received from the subsidiary companies as a direct result of the supervision furnished by the taxpayer and should be taken into account in the allocation of overhead." As the Commissioner points out, however, the Appellant received $150 a month for each well of its subsidiaries that it supervised. Appellant, has not in any way attempted to show that such amount was not fair compensation for the services performed by it or that a larger amount would have been paid had the services been rendered by an independent firm. We can only conclude, accordingly, that as respects the dividends Appellant's relation to the subsidiaries was merely that of a stockholder and that the dividends were properly disregarded in the proration of the overhead expenses.

O R D E R

Pursuant to the views expressed in the opinion of the Board

on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of McVicar-Rood Corporation to a proposed assessment of additional tax in the amount of $1,864.63 for the taxable year ended December 31,1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby modified as follows: Said Commissioner is hereby directed to allow the deduction from gross income of $114,300 as dividends deductible under Section 8(h) of said Act; in all other respects the action of the Commissioner is hereby sustained.

Done at Sacramento, California, this 11th day of May, 1944, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
Geo. R. Reilly, Member
Harry B, Riley, Member
J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary